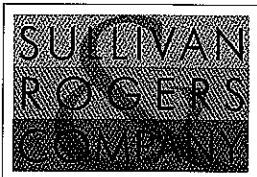


CITY OF NEWTON, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2005



Certified Public Accountants

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To the Honorable Board of Aldermen and Mayor
City of Newton, Massachusetts

In planning and performing our audit of the basic financial statements of the City of Newton, Massachusetts (City) for the fiscal year ended June 30, 2005, we considered the City's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements and not to provide assurance on internal control.

During our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and recommendations concerning those matters. This letter does not affect our report dated October 20, 2005, on the basic financial statements of the City.

The accompanying comments and recommendations are intended solely for the information and use of management and should not be used by anyone other than these specified parties.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with City personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Sullivan, Rogers & Company, LLC

October 20, 2005

CITY OF NEWTON, MASSACHUSETTS

MANAGEMENT LETTER

JUNE 30, 2005

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Status of Prior Year Reportable Conditions Considered to be Material Weaknesses

Reconciliation of Cash and Accounts Receivable

Comment

Our prior year management letter identified reportable conditions (considered to be material weaknesses) in internal control surrounding the cash and accounts receivable processes. Those conditions were as follows:

1. Cash was not reconciled timely between the Treasurer's cashbook and the general ledger (maintained by the Comptroller) during the fiscal year. June 30, 2003 cash was not reconciled until March 2004, or nine months after the close of the prior fiscal year. As a result, the fiscal year 2004 monthly reconciliations were in significant arrears.
2. Individual bank reconciliations were not performed timely during the fiscal year and reconciliations of the vendor and payroll bank accounts were not performed at all.
3. Reconciling items are not investigated and/or resolved timely. For example, we observed one instance where a deposit made during May 2004 was not recorded by the Treasurer or Comptroller until November of 2004.
4. Accounts receivable (i.e., real estate, personal property, etc.) reconciliations between the Treasurer/Collector and the Comptroller were not performed timely during the fiscal year. These reconciliations primarily occurred during the final quarter of fiscal year 2004.

During fiscal year 2005, procedures were implemented to alleviate the reportable conditions (considered to be material weaknesses) surrounding the cash and accounts receivable processes.

However, we did identify certain matters regarding the reconciliation of cash that we want to report to you, which are as follows:

1. Individual bank reconciliations are not always completed the same time Treasurer's cash is reconciled to the general ledger. Until the individual bank reconciliations are complete, the reconciliation of Treasurer's cash to the general ledger cannot be relied upon.
2. We identified several instances where reconciling items identified on the individual bank account reconciliations were not investigated and/or resolved timely.

Recommendation

We recommend that the Treasurer's office implement procedures to perform all bank reconciliations, including the investigation and resolution of reconciling items, no later than 30 days after the end of the previous month.

Management's Response

We agree that substantial progress has been made on the timely reconciliation of cash and accounts receivable. We are committed to continuing to improve the timing of the cash reconciliation of the bank statements to quickbooks. In the last few months we have begun to reconcile the major accounts on a daily basis. This will improve the timing of the bank to quickbooks reconciliation. Delays have occurred due to delays in receiving bank statements, detail for returned checks and detailed charges from several banks. We are hopeful these delays will improve; if not, we will move these accounts to more responsive institutions.

Informational Comment and Recommendation

New Accounting and Financial Reporting Requirements for Post-Employment Benefits Other Than Pensions

Comment

The City provides post-employment benefits (i.e., health insurance) to its qualified retirees. Consistent with other Massachusetts municipalities, the City's OPEB expenditures are financed on a pay-as-you-go-basis from annual appropriations and the City's current financial statements do not report the financial impact of OPEB until the benefits are paid. During fiscal year 2005, the City had 2,429 retirees and/or survivors that received such benefits. For the year ended June 30, 2005, the cost of these benefits totaled approximately \$11,069,000.

The Governmental Accounting Standards Board (GASB) has issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. This Statement establishes the standards for the measurement, recognition, and display of other postemployment benefits (OPEB) expense/expenditures and related assets, liabilities, note disclosures and required supplementary information in the audited financial statements of state and local governments. As part of determining OPEB amounts and disclosures, the Statement requires, at a minimum, a biannual OPEB actuarial valuation. Note that for the past several years the City has had an annual actuarial valuation performed for its OPEB liability. At June 30, 2005, the actuarially determined present value of earned OPEB totals approximately \$654,205,000.

Implementation of this statement will improve financial reporting by:

- Recognizing the cost of benefits in periods when the related services are received by the employer
- Providing information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent those benefits have been funded
- Providing information useful in assessing potential demands on the employer's future cash flows.

Given the significant dollars spent on the City's OPEB plans, the measurement of OPEB under the new standard will have a significant impact on the City's financial statements.

The City's required implementation date of GASB Statement No. 45 is fiscal year 2008.

Management's Response

The City has arranged for an actuarial valuation of its OPEB liability since 2001 and will comply fully with the accounting and financial reporting requirements of GASB statement 45 in our 6/30/2008 CAFR. Any change in OPEB funding requires approval of the mayor and board of aldermen.

Other Matters

Accounting for the Newton Community Development Authority

Comment

The Newton Community Development Authority (NCDA) was established to develop housing programs for low and moderate income families, the elderly and handicapped residents of the City. The NCDA is governed solely by the City's Director of Planning and Development and is funded primarily by federal grants passed through the City and is subject to the same laws and regulations the City is.

The NCDA's financial activity is currently accounted for independently from the City's accounting system. Annually, the Comptroller records a journal entry to include the summary activity of the NCDA in the City's accounting system so the NCDA's activity can be included in the City's annual financial reports.

We believe the maintenance of an independent accounting system places an unnecessary burden on the Office of Housing and Community Development's staff. In addition, because of the separate accounting system, activity of the NCDA is not subject to the automated internal controls inherent in the City's accounting information system.

Recommendation

We recommend that the NCDA's activity be accounted for through the City's accounting system.

Management's Response

The Newton Community Development Authority will discuss with the City of Newton Comptroller the possibility of having NCDA's financial activity accounted for through the City's accounting system. If NCDA determines that such a transfer would not harm its ability to carry out its programs and can come to agreement with the City, then we expect that NCDA's books would be transferred to the City as of July 1, 2006. We expect to make this determination during January, 2006.

Disaster Recovery Plan

Comment

The City has a documented disaster recovery plan that addresses its financial data and related software. However, the plan does not address the hardware required to access the data or the location to operate the hardware. Therefore, in the event of a disaster the City's financial data and software could be recovered, but the City would not have the ability to physically run the software and access the financial data to maintain financial operations.

A well-thought out and documented disaster recovery plan would assist City personnel act quickly and appropriately at a time when the stress and disruption of a disaster might adversely affect their memory, emotions, and judgment. It would also help others take charge in place of managers who might be unavailable at the time of the crisis. In addition, while developing the plan, management personnel could take the opportunity to reassess the adequacy of its property insurance.

Recommendation

We recommend that management include the hardware required to access financial data and the location to operate the hardware in the current disaster recovery plan.

Management's Response

Funding for off-site hardware will be requested to ensure that the City will be able to continue processing financial applications in the event of a disaster at the primary production site.

A more detailed procedure manual will be developed to allow persons unfamiliar with current financial software to process financial applications in the event current personnel are unable to do so.

Financial Policies and Procedures Manual

Comment

We believe that preparation of a formal policy and procedures manual would improve and standardize the City's financial policies and procedures. Without formalized written policies and procedures, the City is inherently subject to everyday inconsistencies in its operations. It is also difficult to measure performance and efficiencies without a baseline. The number of such inconsistencies can be minimized by the written codification of policies and procedures and insistence on adherence to them.

Such a manual should include policies and procedures relative to all financial functions and processes, including, but not limited to, the following:

- Cash receipts
- Purchase orders
- Cash disbursements
 - Payroll
 - Vendor
- Administration of grants
- Administration of student activity funds
- Personnel (i.e., hiring, payroll and related changes, etc.)
- Month-end and year-end closing procedures

The manual should also clearly define the objectives, responsibilities and authorizations for all employees/job positions.

The use of written policies, procedures, and job descriptions in conjunction with specific assignment of responsibilities would increase supervisory personnel's effectiveness. Such written documents would decrease the time spent on supervision of clerical personnel and in attempts to define job responsibilities on each occasion of employee turnover.

Recommendation

We recommend that management develop and implement a formal financial policies and procedures manual.

Management's Response

Management is in full agreement with this recommendation. During the fiscal year beginning July 1, 2005 the City has implemented new financial accounting/reporting and human resources software. Plans have begun to document new procedures and to formalize these into appropriate written form.

Fraud Risk Assessment

Comment

When internal controls are *initially* implemented, they are usually designed to adequately safeguard assets. However, over time, these controls can become ineffective due to changes in technology, operations, etc. As a result, all municipalities should periodically perform a risk assessment to identify, analyze and manage the risk of asset misappropriation. Risk assessment, including fraud risk assessment, is one element of internal control. The City, like most Massachusetts municipal organizations, does not adequately perform this assessment.

The fraud risk assessment can be informal and should be performed by a management-level employee who has extensive knowledge of the City's operations. Ordinarily, the management-level employee would conduct interviews or lead group discussions with personnel who have extensive knowledge of the City's operations, its environment, and its processes. The fraud risk assessment process should consider the City's vulnerability to misappropriation of assets. When conducting the assessment, the following questions should be considered:

- What assets are susceptible to misappropriation?
- What departments receive cash receipts?
- What departments have movable inventory?
- How could assets be stolen?
- Are there any known internal control weaknesses that would allow misappropriation of assets to occur and remain undetected?
- How could potential misappropriation of assets be concealed?

Once the areas vulnerable to fraud have been identified, a review of the City's systems, procedures, and existing controls related to these areas should be conducted. The City should consider what additional controls (*if any*) need to be implemented to reduce the risk of fraud.

Recommendation

We recommend that management develop and implement a fraud risk assessment program to identify, analyze, and manage the risk of asset misappropriation.

Management's Response

Management is in complete agreement with this recommendation and will continue to work towards the development and implementation of a formal fraud risk assessment program.

Student Activity Funds

Comment

The City's elementary schools have not adopted the student activity fund law as defined in Chapter 66 of the Acts of 1996 (Act). In summary, the Act requires the following:

- The School Committee to authorize School Principals to receive funds in connection with the administration of student activities.
- Student activity funds to be deposited with the Treasurer into a separate interest bearing account (Student Activity Agency Account).
- Interest earned on the Student Activity Agency Account to be retained by the fund and disbursed at the discretion of the School Committee.
- In addition to the Student Activity Agency Account, the School Committee may authorize School Principals to establish a separate checking account (Student Activity Checking Account), which may only be used to disburse funds for the exclusive benefit of student activities.
- The School Committee to establish a maximum amount to be maintained in the Student Activity Checking Account.
- Funds, up to the maximum amount authorized by the School Committee, to be transferred from the Student Activity Agency Account to the Student Activity Checking Account (via the City's warrant process) to initially fund the Student Activity Checking Account.
- Periodically and to the extent funds are available in the Student Activity Agency Account, the City to reimburse the Student Activity Checking Account through the City's warrant process.

Recommendation

We recommend that all student activity funds be maintained in accordance with the Act.

Management's Response

Of the Newton's fifteen elementary schools, one school, Bowen Elementary School, has a student activity account in accordance with Chapter 66 of the Acts of 1996. Several of the elementary schools have opted not to maintain student activity accounts. The remaining group of elementary schools has student activity funds between \$1,000 and \$10,000 per year. Efforts will be made in this fiscal year to bring elementary schools into compliance.

Old Outstanding Checks

Comment

The vendor and payroll outstanding checklists maintained by the Treasurer include many checks greater than three (3) months old totaling approximately \$1,035,000. Typically, checks greater than three (3) months old reflect checks that have been void, lost, misplaced or stolen. There is currently no process/procedure in place to investigate and resolve the status of these checks.

Recommendation

We recommend that the Treasurer/Collector's office implement monthly procedures to investigate and resolve outstanding checks greater than three (3) months old. Implementation of this recommendation will strengthen internal controls over cash disbursements.

Management's Response

We agree with the recommendation of a regular process for investigating and resolving old outstanding checks and the tailings process. We have begun the process by starting with the oldest checks first as staff time permits. Future union contracts will require direct deposit for new employees, which over time will eliminate all payroll checks.

Unauthorized Bank Accounts Using the City's Tax Identification Number

Comment

We identified 40 bank accounts that are using the City's tax identification number that are not authorized by the Treasurer. Usually these accounts represent quasi-governmental organizations, such as parent teacher organizations, booster clubs, etc. However, since these accounts are maintained under the City's tax identification number, the City is at risk if fraudulent activities were to occur in any of these accounts. Additionally, the Treasurer should have signature authority on all bank accounts maintained under City's tax identification number and the activity related to the bank accounts should be recorded on the general ledger.

Recommendation

We have provided a list of the unauthorized bank accounts to the Treasurer/Collector. We recommend that the Treasurer/Collector contact the related banks to begin the process of closing all of the unauthorized bank accounts.

Management's Response

We agree and will aggressively work to eliminate all unauthorized accounts by closing them or by having the organizations remove the City's TIN from the accounts in question.